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ABSTRACT

Millions of students are attending classes in substandard schools, a condition that is becoming a major concern for many public school parents, teachers, students, and administrators. This report is the result of research investigating school facility issues, assessing the scope of the problem, and making recommendations to the membership of the Association of School Business Officials International. Each of the following three areas of need are examined: the construction of new facilities and the renovation or expansion of existing ones; payment for accumulated deferred maintenance in existing facilities and adequate maintenance of facilities in the future; and financing of the future depreciation of existing and new school facilities and equipment. The report recommends changes in policies, statutes, regulations, and laws in order to properly address all three areas, including specific proposed actions for the states. Concluding comments suggest that the school districts with the lowest taxing abilities are the ones with the highest levels of deferred maintenance and that facilities continue to be predominately a local concern. The report acknowledges that while there is not enough money to improve all the schools within a state, school business officials must be more creative in their search for financial mechanisms to help solve the problems, coordinate their efforts, and lobby effectively. (Contains 17 references.) (GR)

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A report prepared by ASBO International's Facilities Project Team

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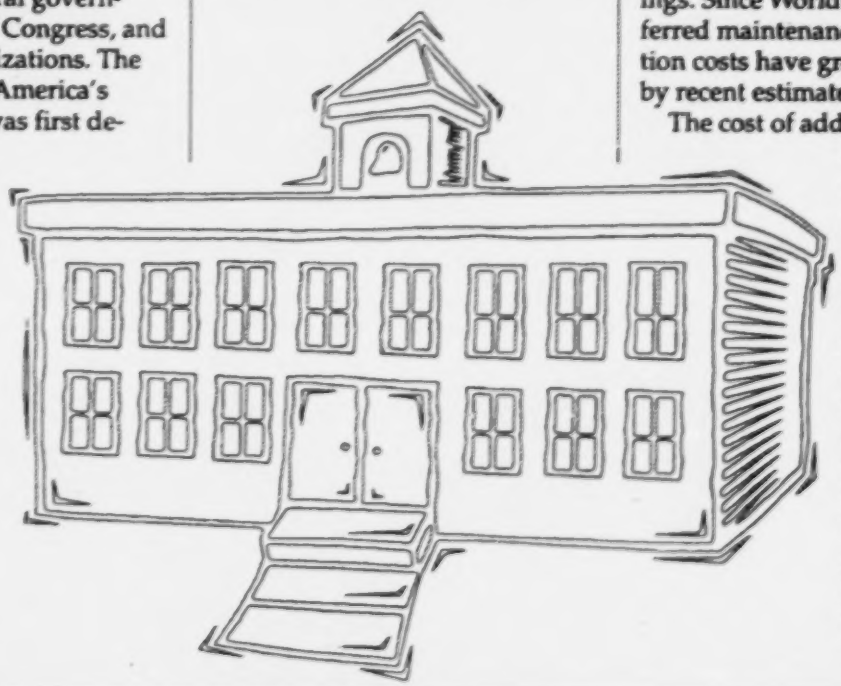
Financing School Facilities

Millions of students in the United States are attending classes in substandard facilities. School buildings are deteriorating at an alarming rate, and the resources required for repair and replacement are not available. School facilities have become a major concern for many public school parents, teachers, students, and administrators.

Reports Cite Poor Conditions

In recent years, reports describing a deteriorating U. S. education infrastructure have been issued by the federal government, Members of Congress, and educational organizations. The poor condition of America's school buildings was first described in a 1983 joint report of the American Association of School Administrators, the Council of Great City Schools, and the National School Boards Association. Other studies followed at regular intervals: *The Condition of Rural School Facilities in the U.S.*, by Honeyman and others, in 1987; *Wolves at the School House Door*, by the Education Writers Association, in 1988; *School House in the Red*, by the American Association of School Administrators, in 1993; and most recently, the five-part study of school facilities conducted by the General Accounting Office (GAO).

These studies document billions of dollars in accumulated deferred maintenance of existing structures; a lack of capital improvement funding for the implementation of new instructional programs (especially technology); and a lack of compliance with federal and state special needs, health, and safety requirements. They find, in other words, that too many school buildings are old, inadequate, in disrepair, and even unsafe.



School Districts Are Overwhelmed

Facility problems afflict urban, suburban, and rural school districts in every state in the country. Almost 50 percent of the nation's school buildings are approaching 50 years of age and are nearing the end of their useful life. School districts are unable to maintain these buildings. Since World War II, deferred maintenance and renovation costs have grown to exceed, by recent estimates, $100 billion.

The cost of adding technology for new instructional programs and delivery techniques also strains the capital budgets of many districts. Although 98 percent of schools had at least one computer in 1996, only 38 percent had

network capabilities. Network connections, including access to the World Wide Web and the Internet, are expensive. Another drain on resources is the unfunded mandate arising from federal laws such as the Individuals with Disabilities Act and the Americans with Disabilities Act to accommodate educational facilities to physically challenged users.

Studies have reported that the maintenance of adequate facilities is an important factor in effective schools and that better learning can be achieved as a result of an improved aesthetic environment. The National Governors' Association Task Force on School Facilities reported that states have a responsibility to ensure a healthy and safe environment for their students, who are required by law to attend school. Furthermore, students are entitled to a facility in which drafts, noise, heat, cold, or general disrepair do not impede their opportunity to learn. Teachers interviewed in another study stated that the physical condition of a building has direct positive and negative effects on teacher morale, sense of personal safety, and feelings of effectiveness in the classroom, and on the general learning environment. Although there is no evidence showing a direct relationship between physical environment and student achievement, planners of school facilities as well as educators hold a consistent view, based on clinical observations, that such a relationship exists, and that it could provide the key to the restructuring of education.

ASBO Looks for Solutions

Some states have responded to the nationwide school facilities dilemma by providing increased funding for building projects. This response, however, has been slow and often inadequate. Further, none of the reports detailing the faults of the nation's education infrastructure have attempted to establish a set of solutions for school management personnel to follow. In view of the national concern, ASBO International assembled a project team of leading school business officials from a cross section of ASBO committees and charged them with investigating school facility issues, assessing the scope of the problem, and making recommendations to the membership.

The team examined the areas of financing, environmental issues, technology applications, operations and maintenance issues, and the development of master plans. While their recommendations may not be appropriate in every situation, they are intended to stimulate dialogue among school business officials in an attempt to move in the direction of answers. Please provide your feedback to ASBO. All school business officials share this problem, and we can all benefit from innovative, viable approaches to its solution.

Three Areas of Need

Local, state, and federal policymakers must consider resource needs in three school-related areas: construction, maintenance, and operation. These needs relate to:
(1) the construction of new facilities and the renovation or expansion of existing ones
(2) payment for accumulated deferred maintenance in existing facilities and adequate maintenance of facilities in the future
(3) the financing of the future depreciation of existing and new school facilities and equipment

New Construction and Renovation

The level of the need for new or renovated facilities is driven by the following factors:
(1) the age of existing facilities
(2) their condition and safety
(3) their adequacy with regard to enrollment growth and the needs of challenged individuals for access
(4) changes in program content and pedagogical approaches

Old schools. Although the United States has built almost $750 billion worth of schools since the turn of the century, estimates show that as of 1993 only 6 percent of them were built since 1980. Recent studies find that over 50 percent of school buildings in the U. S. were built before 1960. While there are great variations within each state, nationally 25 percent of our nation's schools were built before 1950 and 20 percent before 1940. Aged and often obsolete facilities and equipment need continuous renovation and replacement.

Unsatisfactory buildings. The recent GAO report detailing the need for school construction throughout the United States indicates that $112 billion will be

needed to complete repairs, renovations, and modernization sufficient to bring U. S. schools up to a good condition overall. This figure does not cover the new construction needed to meet the continuing growth being experienced by several states. The study also indicates that an estimated 14 million students (in 25,000 school buildings, or 33 percent of the U. S. total) are being educated in unsatisfactory buildings and that 25 million students are in schools reporting at least one unsatisfactory condition, such as leaky roofs, the need for asbestos removal, plumbing problems, or inadequate space.

Increasing enrollments. Total elementary and secondary enrollment continues to increase on a national basis. While some states have experienced stabilization and even decline, most states have experienced increases and will continue to do so for the foreseeable future. Increasing enrollments are creating facility gaps in many school districts. Schools in Florida are growing at an estimated 58,000 students per year; approximately 2 million students will enter California schools by the year 2000; and New York City expects 25,000 additional students annually.

Using the Florida average cost per student station of approximately $11,000, these three examples would in 1 year account for $12.3 billion in new construction needs. Yet conditions vary with each state; in West Virginia, enrollment has declined by 15 percent. Shifting demographic patterns, due to population mobility both between and within states, make state-level decision making



difficult and exacerbate the difficulty of providing adequate facilities within each school district.

Evolving program needs. Appropriateness of facilities to educational programs is another factor that must be considered in any study of public school conditions. In the past, school buildings were constructed with little attention to changing trends in educational programs. The role of the school facility in the educational process began to be defined in the late 1970s, as planners designed schools to fit programs and enhance the educational operation. Today we are aware that an important relationship exists between a program of instruction and its physical environment. A thorough understanding of the factors optimizing this relationship can result in a facility that enhances learning, increases teaching efficiency, and minimizes building deterioration.

Changing technology represents a major challenge to facility planning. There are almost 5 million computers in American schools. Overall this represents 1 computer per 10 students, but it is important to note that this ratio decreases dramatically in poorer school districts. Retrofitting school buildings for such new features as fiber-optic cable and digital switching to support high-band-width networking is costly. Several new schools in Orange County, Florida are equipped with fiber-optic digital teaching stations supported by network capacities, yet many existing buildings in the county are not equipped as well. In Scott County, Kentucky, a high-tech elementary school featuring telephone and computer telecommunication capabilities and a school-wide video television system was built with help from a corporate sponsor. In this school, the media center is linked to each instructional area, and science labs are operated with interactive software that is downloaded to each student.

A number of trends have emerged that will shape the future of educational facility design. The classroom itself will change. The uniform "box" for 30 students will be replaced by a mix of large and small rooms where students can learn in groups of various sizes. Interior spaces will have maximum flexibility to be open or closed and always unencumbered.

Sophisticated electrical and mechanical systems will allow open and subdivided space. Schools will be designed differently for different climates. Lighting, high-technology learning stations, and communication devices will contribute to the new school facility. Passive and active energy designs will be used. Specialized buildings may reflect the popularity of the special-function magnet school. Child-care centers will be prevalent. Round-the-clock use will require better lighting and security systems.

Public school districts must be able to analyze the degree to which their facilities can be altered to accommodate new strategies for the delivery of instruction. In addition to measuring an existing school's current condition and suitability, a thorough building inventory must measure the extent to which structures can house future programs.

Deferred Maintenance Costs

The effects on the educational enterprise of deferred maintenance of facilities and equipment are beginning to be understood. Various studies have indicated that school districts have not invested in maintenance on a regular basis. A 1982 study estimated that repair and modernization of New Jersey's urban, suburban, and rural school facilities would cost $2.8 billion. By 1985, rural Kansas school districts had deferred more than $25 million of needed building maintenance and repair per district. The Council of Great City Schools in 1987 estimated the cumulative cost of deferred building maintenance in the 44 largest urban districts nationwide to be $5 billion. At the national level, studies indicate that deferred maintenance costs have grown from $41 billion in 1988 to more than $112 billion in 1997. If this trend continues, costs will exceed $150 billion by the beginning of the 21st century.

Difficult choices. The rapid increase of deferred maintenance costs over the last eight years may be attributable to the aging of buildings constructed in the fifties and sixties—many of these buildings are entering the high-maintenance phase of their useful life. Another reason for the backlog may be the limited amount of money available to local school districts. In many instances, depending on the state's accounting structure, school districts must target their limited resources on contractual obligations such as salaries, fringe benefits, fuel, and electricity. In other situations, resources are used for instructional programs or on faculty needs. One school district reported that its current maintenance budget allowed for repainting each school building exterior once every 29 years, re-covering every floor once every 39 years, and repainting each interior only once every 47 years.

The growing dollar amounts for deferred maintenance are also attributable to secondary, and sometimes tertiary, effects of the initial neglected repair: the electronic equipment that must be repaired, the carpet that must be replaced, and the wall that must be replastered because the roof leaked.

Diminished budgets. As collective public bargaining pressures have forced local school boards and administrators to place greater emphasis on meeting salary and operating-cost demands than on meeting facility needs, and as demand for new materials and equipment rises to meet changing student needs, there has been a reciprocal reduction in the resources allocated for maintenance at all budget levels. The very nature of the turnover of school boards and school administrators results in a greater orientation to short-term operating needs than to long-term capital needs; when a school board and superintendent have to decide between adequately compensating teachers and repairing or renovating school facilities, the former usually wins out. It is no surprise that the percent of budget devoted to all facilities maintenance by school districts in the U. S. shows an inverse relationship to deferred maintenance levels. From a high of 14 percent in 1920, the proportion of budget expended for maintenance has declined steadily to 9.6 percent in 1960 to 6.7 percent in 1982 to 3 percent in 1992. The increasing levels of deferred maintenance can be partially explained by diminished maintenance budgets.

Future Depreciation

The third financing need is to fund future depreciation of school facilities and equipment. Even if new and expanded facilities were financed adequately, and even if all accumulated deferred maintenance was somehow creatively financed,

there would still remain a need to finance the ongoing depreciation of existing facilities and equipment in anticipation of replacement. We should not make the same mistakes twice.

The Need for Equity in Financing Facilities

Federal, state and local policymakers must recognize that the financing of school facilities and equipment is no different from the financing of operating costs in terms of the need for equality of resource accessibility. Adequately trained and resourced teachers, support staff, and programs financed on a fiscally neutral basis will not necessarily provide an equitable educational program without equitable facilities and equipment. Policymakers must institute equalized financing formulas to help pay for facilities and equipment at the local level. Without this recognition of state responsibility, adequate facilities and equipment will never be realized across school districts to meet the challenges of the 21st century. In several states, policymakers and even the courts have declined to recognize what many consider to be a constitutional responsibility to provide adequate educational facilities and equipment on a fiscally neutral basis. In other states, such as Arizona, Ohio, and Alabama, the question has been addressed by the courts and remedies imposed. It is a question that may well become the most litigated arena of school finance in the 21st century.

At First, a Local Matter

Historically, the financing of school facilities and equipment has been considered a local matter. The financing of school construction was of little concern in the early years of our country; schools were constructed by community members, with no thought to tax rates, bonds, or bond referendums. When, a hundred years ago, state legislatures began enacting laws to allow the issuance of debt for public school districts, they were primarily concerned with three things: (1) protection of the bond purchasers, (2) limitations on the amounts spent on construction, and (3) limitation of the public debt. Little direction was given regarding the building being constructed. Through the early 1900s, the major responsibility of financing the public school building rested with the local community. By the early 1940s, only 12 states had made any financial provision for assisting school districts with construction.

The Limits of State and Federal Involvement

Educational policymakers have long recognized that total local financing of education can result in great disparities and school building inadequacy. In recent decades, most states have created funding mechanisms to at least partially finance school facilities and equipment, and several states have devised funding schemes on the basis of fiscal neutrality. Approximately three-fifths of the states now support school construction in some way. These state initiatives vary from full state support to loan programs, formula plans and flat grants. Several states consider the local school district's ability to pay in calculating their support for school construction. State aid for capital outlay and debt service has grown from $78 million in 1951 to approximately $1.4 billion in 1979 to $3.5 billion in 1994. At last count, 13 states had established comprehensive school facility operations at the state level, and this number is growing. Still, school districts must continue to fund school construction as part of the local district budget or through bonds funded by property tax. In general, state plans for financing school construction have been inadequate for meeting present school facility needs.

Federal support for school construction has been proposed but never funded by the Congress. The 1994 Education Infrastructure Act proposed $100 million to assist with needed school construction, but the funds were eliminated in the budget balancing of 1995. The Safe and Affordable School Act of 1997 would have spent $5 billion on school construction in the fifty states, but it too was negotiated away in the first half of the 105th Congress budget talks. Likewise, the federal effort to allow $5 billion worth of debt service support for school construction, proposed in February 1998, was also unsuccessful.

Traditional Financing Methods

Traditionally, school facilities and equipment have been financed in two ways: either by the proceeds of a tax-exempt municipal bond issue or by some type of state equalized funding formula that typically provides a few hundred dollars per student annually. These methodologies are significantly limited in terms of equity in the first case and of adequacy in both cases. Furthermore, neither provides for direct funding of annual depreciation. This lack results in the significant accumulated deferred maintenance that is evident today in school district facilities.

Bond Issues

Due to increased social mobility, taxpayers who approve local referenda initiatives to finance facilities with bond issues are typically not the same taxpayers who end up paying for the facilities through long-term debt financing supported by local property taxation. However, the economic theory of intergeneration asserts that future generations should share in these costs because the users of school facilities will include those future generations. Both the security of the general obligation bond and the ability to spread the cost of building a new school among current and future taxpayers have led many school districts to choose this method of financing. Annual debt payments are typically stretched over thirty years and are repaid through property tax levies and, in some states, state equalized aid formulas. The use of property tax levies to support school construction, however, has a troubled past.

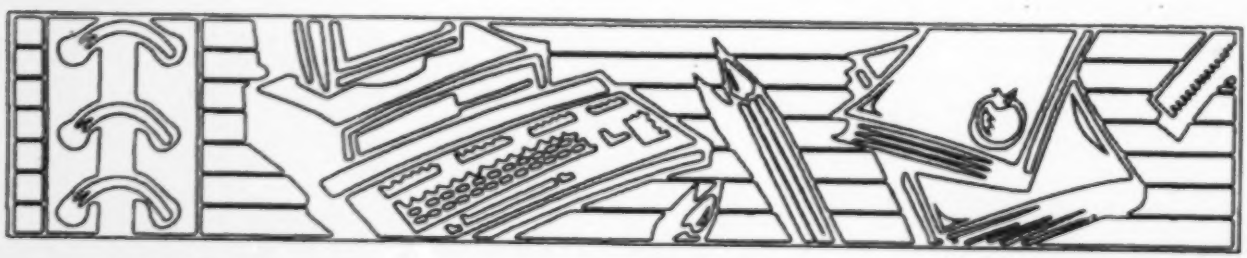
Many state tax abatement and rollback provisions, including the highly publicized Proposition 13 in California, evolved as resistance to property tax increases in the two decades following the launching of school finance reform in 1971 with the Serrano v. Priest case. Between 1976 and 1980, 18 states established some type of limitation on taxes or expenditures. The 1994 decision by the Michigan legislature to abolish the property tax as a means to finance public education was indicative of taxpayer dissatisfaction with tax increases in general and property tax increases in particular.

Taxpayer dissatisfaction in the 1990s had both economic and demographic roots. Double-digit inflation in the 1970s and early 1980s significantly increased both property value assessments and the cost of educational services. A 1992 study found that although personal income was rising at the same rate as the assessed valuation of property, taxpayers tended to pay more attention to the total amount of their taxes, rather than the percent of income they represented. Retirees and other people on fixed incomes worried that rising assessed values and higher tax bills would eventually force them to sell their homes. The practice of requiring the taxes to be paid in annual or semiannual payments upon receipt of a bill added to taxpayer resistance.

The growing opposition to school taxes in the 1990s was furthered by changing demographics. While baby boomers and preboomers were getting older and moving into groups that tended to be less supportive of school tax issues, postboomers lacked the job prospects and the disposable income to be supportive. Additionally, groups that had a smaller personal stake in schools, such as senior citizens, childless couples, and single individuals, were increasing in numbers. These changes, coupled with a history of property tax resistance, cloud the public support issue for the future.

State Funding Formulas

An example of the use of state funding formulas can be drawn from the state of Florida. With more than 80 percent of the state's general revenues coming from sales taxes due to a constitutional ban on a personal



income tax, school districts in Florida wrestle with how to provide for the over 58,000 new public school students projected annually through the year 2000. An estimated 1100 schools at a cost of $7.9 billion are needed to accommodate the increased enrollment.

State funding for school construction in Florida is provided for in two sections of the state constitution. Article XII, Section 9(d) provides a stated amount to each school district annually from motor vehicle license fees. Article XII, Section 9(a)(2) stipulates that school districts can share in the proceeds from gross utilities taxes as provided by legislative allocation. Such proceeds are referred to as Public Education Capital Outlay (PECO) funds. These funds are bonded at the state level and distributed to school districts. In addition to motor license fees and PECO funds, the state legislature funds specific public school capital outlay projects from the state lottery fund, the Educational Enhancement Trust Fund. In several instances, however, support for capital outlay projects funded with local tax revenues has been adversely affected by the public's misconception of the magnitude of lottery-generated dollars.

In addition to receiving state funding for capital outlay needs, local school boards in Florida are authorized to set the following types of tax levies for school construction:
(1) Capital outlay and maintenance. Florida statutes permit local school boards to levy up to 2.0 mills for new construction and remodeling, site and site improvement, maintenance and repair, and school buses. A percent age (not to exceed 1/2) of the proceeds from this levy may be used to make payments on educational facility lease-purchase arrangements.
(2) Local capital improvement reserve fund. For this use, Florida school districts are allowed an election to approve an ad valorem capital outlay tax for a period not to exceed two years.
(3) Voter approved debt service. As is true in most states, Florida describes the process for approving bond issues. Statutes limit school districts to taxation of 6 mills for 20 years and further prohibit school districts from issuing school bonds in excess of 10 percent of the nonexempt assessed valuation of the district without state board approval. In addition, school boards are allowed to levy a 0.5 percent sales tax for capital outlay, if approved by a referendum. However, if a district imposes the surtax it must then freeze, for at least three years, the non-capital, local school operating millages at a rate not to exceed the prior year's rate.
(4) The lease-purchase provision of the statute on the capital outlay and maintenance tax allows Florida school districts to issue "certificates of participation" in amounts sufficient to construct new buildings and to make lease payments with up to one half of the annual proceeds. Certificates of participation are insured financial instruments issued by a non-profit corporation on behalf of the local school district for the purpose of building a school. No voter referendum is required; the local school board makes the decision. Investors are repaid by lease payments, approved annually by the local school board. Should a board default on a lease payment, insurance on the certificates of participation repays the investors at the end of the term of the certificates and the title reverts to the school district.

Innovative Financing Strategies

In recent years, school business officials and their colleagues have become extremely creative in identifying alternative methods of financing capital needs. A number of these creative approaches are described below. However, it must be noted that the vast majority of resources to pay for capital costs—perhaps as much as ninety-five percent — originate from traditional tax-exempt debt financing.

Development or Mitigation Fees

Development or mitigation fees (also known as impact fees) have become popular in some states, particularly those experiencing high growth, as a method of financing the capital costs of school facilities and equipment. These fees are paid by real estate developers to the local school district when new construction projects or developments are proposed. In theory, and probably in practice, these fees are then transferred to those who purchase the property, build homes, and avail themselves of the educational infrastructure. This sensible approach recognizes that the development of real estate results in additional

students and an increased demand for school facilities. It is reasonable to pass the cost of these facilities along at the time the real estate developments are approved.

Corporate-Sponsored Schools

Corporate-sponsored schools, in which a corporation pays for the facility and equipment but not the operating costs, have been established in a number of metropolitan areas. The primary advantage to the corporation is the provision of satisfied employees, since the children of employees are given enrollment priority. In several locations, however, this practice has caused controversy, since the children of non-employees can attend these schools only on a space available basis. Also, the corporation may sometimes intervene in the operation of the school to protect its interests in the project. An example of a corporate-sponsored school is the Celebration School in Osceola County, Florida, sponsored by the Disney Corporation. In addition, the American Bankers Insurance Group, Florida Power and Light, Inc. Mount Sinai Medical Center, and the Miami International Airport Authority have built satellite learning centers for the Dade County, Florida public schools.

Charter Schools

The recent school reform movement has established charter schools in a number of states. By the end of 1997, there were 428 charter schools operating in 25 states. The establishment of charter schools typically does not require provision for capital costs, as most states make provision for the use of existing facilities within the community before approving a charter request. While the trend is for states to increase support for capital outlay requests specifically for charter schools, there is a benefit associated with locating them in existing facilities—they thus expand the availability of facilities for education and allow school districts to direct scarce capital cost resources to the students remaining in the regular public school system.

Higher Education Affiliation

Recently, a number of public school districts across the nation have established affiliations with post-secondary institutions, particularly community colleges and schools of education at colleges and universities. In several states, funding is available for the development of joint-use educational facilities. This mechanism is especially useful in locations where debt financing for competing educational systems is difficult to achieve. When a school district and a community college build a joint-use structure, it is often perceived as a cost-effective alternative to separate facilities. In addition, this type of venture seems to mark a return to the "laboratory school" model. When a university college of education operates such a school it typically relieves the local school district of the need to gather resources to pay for the capital costs of these facilities, thereby redistributing scarce resources to the remaining students in the public education system.

Local Government Partnerships

To acquire certain types of support facilities, public school districts may jointly develop them in conjunction with other local units of government, such as municipalities, counties, and park and recreation departments. The types of facilities developed include recreational facilities (such as pools, gymnasiums and playing fields) and technology centers and libraries. The partners share capital cost, the operating cost, and the utilization of these facilities.

State and Federal Competitive Funding Programs

Some states and the federal government have created competitive grant programs to assist school districts in accessing resources for school facilities and equipment. These programs work well for a number of reasons. First, they help target the resources to those school systems that have the least ability to fund the cost through local property taxation. Second, they provide an opportunity to develop experimental and creative types of facilities and equipment to provide a "lighthouse" for other school districts to emulate. However, the amount of funds available through this strategy is extremely limited.

Local Fundraising

Some school systems have created local foundations in recent years in order to raise contributions from the public to support school operations. The contributors include individuals, foundations, and corporations. Usually, the funds raised are

applied to supplemental facility and equipment needs such as computer laboratories. Even the most successful local school district foundations, however, have only raised very limited resources. The opportunity to raise the resources necessary to meet the total capital costs of a school district is very limited if not nonexistent. One need only look at the efforts of private and public institutions of higher education: fewer than 100 of 3500 institutions of higher education have generated sufficient resources to cover the cost of their capital needs. Furthermore, this has occurred over multiple decades, if not centuries, of fundraising efforts. Clearly, the use of fundraising and capital campaign techniques will allow local foundations to provide only marginal resources to supplement the capital cost needs of school districts. There should be no doubt that these limited resources will never cover total capital cost needs.

Achieving a Successful School Bond Election

If the vast majority of resources to pay for capital costs are to be raised, as previously stated, by the traditional tax-exempt debt financing method, perhaps suggestions for ways to achieve a successful election would be in order. As the Council of Educational Facilities Planners has indicated, obstacles to the public support of bond elections commonly arise from
(1) Unwise scheduling. Elections held following the appointment or election of a new superintendent and those held at the beginning of a new school year are more likely to be successful.
(2) Failure to present a clear and concise picture of the need for the bond funds. Voters tend to make their individual decisions at the time they first hear of the proposed election.
(3) Failure to use all available media. Organized opposition is harmful, and every effort must be made to convince all constituent groups of the benefits of the election.

Recent studies of successful bond referenda have noted several factors that have correctly predicted referenda outcome. These include:
(1) The bond amount. Voters must perceive that the amount requested is reasonable, not excessive, and will meet the described needs of the school district.
(2) The percent age of the county population with a high school diploma. Persons with a high school diploma have a tendency to support election efforts.
(3) The percent age of the county population that is female. Women, especially seniors, tend to support school bond initiatives.
(4) The percent age of the county population that is nonwhite.
(5) The total amount of taxable property (business and residential) in the county.

In a 1994 study using a median voter model of economic (bond amount, median house value, taxable property value, unemployment rate, percent age of families in poverty) and demographic (percent age of females, percent age of nonwhites, percent age of high school graduates) variables predicted with 86.11 percent accuracy the outcomes of bond referenda in one state.

In other studies of school bond referenda, the following variables have been reported to influence outcomes: (a) rampant immigration, (b) community involvement, (c) personal charisma of superintendent, (d) use of a public relations consultant, (e) timing to coincide with a presidential primary date, (f) state-level equity in funding capital projects, (g) targeted appeals to ethnic groups, (h) demonstration of need, and (i) lack of organized opposition.

Recommended Changes in Policies, Statutes, and Laws

In order to meet school capital funding needs in the three areas of construction, maintenance and operation, we believe change is needed in policies, statutes, regulations, and laws that presently restrict the opportunity of school districts to raise funds. Specifically, we recommend that the four policy changes described below be reviewed and approved by the appropriate legislative and jurisdictional authorities.

Depreciation Accounting

Historically, local units of government, including school districts, have recognized capital costs as an expense at the point of acquisition. This means there is no provision for recognizing the cost attributable to facilities and equipment that is "used up" each year. The Financial Accounting Standards Board

requires that nonprofit organizations recognize capital assets on a depreciated basis. This requirement was implemented by those organizations in recent years. Most non-profits were initially averse to this new requirement; after implementation, however, most welcomed this opportunity to expense capital assets as they depreciate. In this manner, these organizations are able to generate annual funds to replace the amount of assets depreciated on an annual basis. We recommend that the Governmental Accounting Standards Board institute depreciation accounting standards for public school districts.

A voluntary compliance system is not sufficient, since local school districts are under pressure to use their scarce resources to meet operating costs. Further, we recommend a phase-in period of five to ten years to allow school districts to gear up to meet depreciation costs by obtaining additional revenues or reducing other expenses. We estimate that the annual depreciation cost for a typical school district is approximately 5 percent of the operating budget or 2 percent of the estimated future replacement cost of all educational facilities and capital equipment. At present, most school districts are expensing approximately 2 percent of annual budget on capital purchases. Therefore, an additional annual expense of approximately 3 percent will need to be recognized by school districts. Over a five-year phase-in period, this means an additional .6 percent in operating expenses will be recognized each year; on a ten-year basis this would mean an additional .3 percent operating expense for depreciation purposes. Finally, we recommend that these capital recovery funds be segregated from other school district funds, to be used only to replace and renovate equipment and facilities. This methodology will smooth out the peaks and valleys of funding school district capital costs, provide a rational and sequential method of funding school capital needs, and provide sufficient resources to replace and renovate existing capital facilities and equipment. It is a travesty that such an accounting mechanism has not been in place. If there had been such a requirement in the past, we would not be in the critical position we are in today.



Lease/Third Party Financing

A new, publicly financed capital market has recently emerged in an incredible few years. This market, which provides capital for direct lending, direct mortgage instruments, and real estate investment trusts, correlates strongly with traditional capital markets such as those in equities and fixed income securities. The market's great liquidity makes it a significant new resource for financing capital needs. However, certain constraints of the tax-exempt market prevent school districts from accessing this liquid capital. Investors are generally required to fund capital expansion on a taxable basis, which inflates the cost of capital to school districts by approximately 25 percent. Generally, school districts are not able to extend their tax-exempt status to these private investors, who must pay local, state and federal income, sales, excise, and property taxes. Why would a school district access this market and pay a 25 percent premium over the tax-exempt cost of funds? If federal and state law were changed to allow these private funds to receive a tax-exempt return, a viable alternative funding resource for school districts would be available. Long-term leases would enable school districts to maintain flexibility in meeting capital needs. The capital marketplace could create an instrument similar to municipal tax-exempt bond funds. Maintenance of facilities would be provided by the lessor, who would have an incentive to maintain facilities and equipment throughout life cycles. We recommend that the limitations of federal and state tax policy which inhibit this very opportunistic funding model be relieved.

Innovations in Delivery Methodology

Over the last few decades, a number of new methodologies for the delivery of design, construction and equipment have been developed by industry. These include such innovations as design/build construction, commissioning contracting, performance contracting, value

engineering, and project-cost managing. These delivery methods are thought to be more efficient and effective than traditional public bidding processes. For this reason, a large number of private enterprises have commenced the use of these methodologies in recent years. On the other hand, public school districts are usually limited by regulation, statute or other requirements from participating in these more effective, efficient, and creative approaches to providing goods and services to school districts. This is not meant to imply that a competitive playing field cannot be created with these approaches—nothing is further from the truth. However, negotiated cost-savings can only be realized through relief of public bid laws or further education of those who purchase services. We recommend that federal, state and local education policymakers review the restrictions imposed by statutes, laws, or regulations that inhibit the use of these creative delivery methodologies.

Investment of Bond Proceeds

Investing bond proceeds is an effective and efficient method for expanding the ability of school districts to adequately fund capital projects. The limitations imposed by the Internal Revenue Service (IRS) and many state legislatures prevent school districts from investing bond revenues in creative, high-yield financial instruments. While every school business official is aware of the need to be prudent and careful with school district investments, the spend-down provisions and revenue-yield restrictions of the IRS code related to arbitrage are complex and often costly to monitor. However, recent changes to the code (effective December 31, 1997) increased the arbitrage exemption for qualified school construction activities from $5 million to $10 million per year, and efforts in the U. S. Senate Finance Committee have been directed at raising it even higher. These rules should be relieved at the state level as well. Expanding the exemption will allow school districts to invest bond proceeds to achieve higher returns. At this time, several school districts are investigating bank debenture issuance programs for investing bond proceeds. These programs have a proven track record and provide high yields (often exceeding 30 percent per year) to public investors. We recommend that the federal government and the states implement changes to allow the arbitrage exemption be expanded to at least $25 million for qualified school construction activities

Three-Year Safe Harbor

Another creative finance concept is the proposal to implement a 3-year safe-harbor exemption from the arbitrage rebate rule for the financing of school construction. Under this concept, bond issues greater than the allowed small issuer exemption would have the following spend-down requirements: 15 percent by the end of year one, 95 percent by the end of year three. This simplification of spend-down provisions would benefit small and large districts alike and would hopefully spur new construction throughout the U. S.

Bank Deductibility

Currently, local banks cannot purchase tax-exempt bonds in excess of $10 million from a school district and deduct the interest expense. If an exception were made to allow banks to purchase tax-exempt bonds for local school construction without loss of a deduction for the interest expense attributable to those bonds, local finance authorities could more easily support school construction activities in their area.

Expansion of Private-Activity Bond Classification

Under current federal law, states are limited in the amount of private-activity bonds that private developers and construction firms can receive for larger qualified construction projects such as airports and hydroelectric projects. The extension of the definition of qualified projects to include school construction and the exemption of those bond amounts from the state volume cap would greatly enhance private participation in school construction. Under such a plan, private developers could qualify for tax-exempt financing to build schools as part of larger development projects and could implement lease purchase agreements with the school district to help repay the debt. In addition, if such facilities received accelerated depreciation status, similar to residential rental properties that are bond financed, there would be increased incentive for the private sector to build, rehabilitate and maintain school facilities.

Proposed Actions for States

Over the last few decades, state-level educational policymakers have increasingly recognized their fiscal responsibilities toward local school districts. However, this recognition has largely involved operating costs and not capital costs. In fact, many state policymakers have enacted laws reducing or relinquishing state responsibility for the provision of adequate facilities and equipment in an attempt to define this as a local matter. We argue that state policymakers should review these decisions, as the state's responsibility for education does extend to facilities and equipment. In particular, we believe that state legislative bodies and administrative officials should pursue the following actions:

(1) Renew their commitment to establishing standards of educational adequacy and safety in school facilities and equipment.
(2) Re-establish or strengthen offices for the oversight of school facilities and equipment.
(3) Enact laws and regulations that require proper school facilities and equipment.
(4) Maintain databases recording the condition of school facilities and equipment.
(5) Establish standards for the application of technology in school facilities.
(6) Provide state-level funding for an equalized method of school construction financing.
(7) Provide supplemental resources for (a) incentive programs for the development of model school designs and other competitive "lighthouse" grant programs, and (b) assistance in specialized need areas such as property-poor school districts, high-growth areas, and regions affected by catastrophic emergency conditions.

Conclusion

The condition of educational facilities is a major concern in every state in this country. Local communities are faced with the costs of facilities, extraordinarily high in comparison with other educational expenditures. Many school districts are facing great opposition from patrons who do not understand the need for facilities that are both adequate and exemplary. Subsequently, these school districts have experienced significant reductions in funding for capital outlay.

While the school finance literature regularly discusses adequacy and equity issues, a small but increasing amount of research is applying a concept called fiscal neutrality to school facilities. As a number of studies have indicated, there is a growing need for modernization, renovation, and replacement; there is also cumulative analysis that indicates a direct relationship between the wealth of a school district and the condition of its educational facilities; that equity may be applied to funds for capital outlay. There is also a growing interest by the courts in mandating that provisions for replacing or renovating outmoded physical plants be incorporated into school finance systems. While these issues impact all states, they are of even greater significance to those states in which there is no or limited state funding for capital outlay and where it is becoming more widely accepted that school facilities be considered in the total mix of "equitable educational funding" within a state. The evidence gathered in all major studies suggests that the school districts with the lowest taxing abilities are the ones with the highest levels of deferred maintenance. Therefore, the districts with greater needs are the ones less able to pay for repairs or replacements.

The methods used by the states for the funding of facilities are very diverse, but reliance on the traditional revenue sources of local taxing authority and bond issuance predominates, with lesser funding support systems, such as equalized funds and matching grants, also in use. The evidence suggests that facilities continue to be predominately a local concern. As the methods used to fund these projects reflect a greater and continued dependence on local wealth, the result will be increased levels of unmet facility needs. This implies two avenues to a solution: first, alternative sources of funding must be developed; second, more efficient and effective methods must be permitted for leveraging the funding available for school construction. The solution will require a comprehensive approach— a combination of innovative planning of site selection, facility design, and construction; cost containment initiatives; use of depreciation accounting standards; improved

maintenance scheduling; creative uses of existing facilities; implementation of creative investment strategies and capital fund maintenance programs; and changes to state and federal laws which hamper the ability of school districts to efficiently and effectively manage capital projects and the funds necessary to fulfill their needs.

There is a small window of opportunity available to school districts to make the case for changes in policy at the state and federal levels. Almost every state legislature is discussing the school facility problem and many states are implementing programs to meet their needs. But this window will soon close as other issues arise to take the floor. School business officials must work in a coordinated united front to lobby for change and creative methods for solving the problem. For example, the recent transportation bill passed by Congress and signed by the President will make more than $200 billion dollars available to the states for roads, highways, bridge construction and other infrastructure projects. School districts use roads, bridges, and highways. School buildings are part of this infrastructure. Schools require parking facilities, access routes, and modifications to existing roads and highways to facilitate the movement of buses and cars. School business officials can work closely with their counterparts in states departments of transportation to fund improvements that will benefit schools and contribute to their total capital needs.

There will never be enough money to build or improve all the schools needed in all the states. School business officials must become even more creative in their search for mechanisms to help solve their school facility problems. They must coordinate their efforts and lobby effectively. Business officials from small rural districts must work with personnel from large urban districts to achieve a common goal—building the educational facilities we know every child needs and deserves. ■

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Facilities Project Team

ASBO International and Johnson Controls, Inc., joined forces to examine crucial issues that impact school facility infrastructure. *Financing School Facilities* is the first of three publications to assist school business officials with the challenges of improving school infrastructure. To research and gather this type of information, a project team was assembled from a cross-section of ASBO International's volunteer committees. Members of the project team include the following:

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About ASBO International

The Association of School Business Officials (ASBO) International is a professional association representing over 6,000 members. ASBO provides programs and services to promote the highest standards of school business management practices, professional growth, and the effective use of educational resources. You can access ASBO International 24 hours a day by visiting our website at http://www.asbointl.org.

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